Office - Supreme Court, U.S.
FILED
JUN 8 1956
HAROLD B. WILLEY, Clerk

No. [redacted] 145

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

F. A. LESOURD,
Attorney for Petitioner.

15th Floor, Hoge Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

No. .....

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

F. A. LESOURD,
Attorney for Petitioner.

15th Floor, Hoge Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Involved	2
Statutes Involved	3
Statement	5
Reasons for Granting the Writ	12
Conclusion	31
Appendix "A"	33
Appendix "B"	47
Appendix "C"	49

TABLE OF CASES

Beggs v. United States, 27 F.Supp. 599 (Ct. Cls.)	14, 19, 22
Bowers v. Slocum, 20 F.(2d) 350 (C.A. 2d)	19
Comm. v. Citizens & Southern National Bank, 147 F.(2) 977 (C.A. 5th)	19, 22
Comm. v. Orton, 173 F.(2d) 483	24
Comm. v. Upjohn's Estate, 124 F.(2d) 73 (C.A. 6)	12, 13, 22
Cummings-Collins Foundation, 15 T.C. 613	29
Donner, Wm. H., 40 B.T.A. 80	22, 29
Eaton, Ralph H., Foundation v. Commissioner, 219 F.(2d) 527 (C.A. 9)	24
Germantown Trust Co. v. Comm., 309 U.S. 304, 84 L.Ed. 770, 60 S.Ct. 566	30
Harrison v. Barker Annuity Fund, 90 F.(2d) 286 (C.A. 7)	29
Hopkins, Lydia, 13 T.C. 952, 973	19
Hunton, Eppa IV, 1 T.C. 821	22, 29
Irving Bank-Columbia Trust Co., 8 B.T.A. 833	19
Johnson, E. C., Executor, 13 B.T.A. 850	19
Jordan, Arthur, Foundation v. Comm. (C.A. 7) 210 F.(2d) 885	12, 13
Mallinckrodt, Edw., Jr., 2 T.C. 1128	29
McClung, Hu L., et al., Executors, 13 B.T.A. 335	19

Page

Mellon, A. W., 36 B.T.A. 977 29
Mueller, C. F., Co. v. Comm., 190 F.(2d) 120 (C.A. 3) 24, 25
Old Colony Trust Co. v. Comm., 301 U.S. 379, 81 L.Ed. 1169, 57 Sup.Ct. 813 ..... 23, 24
Ould v. Washington Hospital for Foundlings, 95 U.S. 303, 24 L.Ed. 450 14
Schoellkopf v. U. S., 124 F.(2d) 982 (C.A. 2), 36 F. Supp. 617 (W.D.N.Y.) 29
Sico Co. v. United States, 102 F.Supp. 197 (Ct. Cls.) .. 25
Simpson, Louise V., Estate of, 2 T.C. 963 29
Slocum, Herbert J., et al., Executors, 6 B.T.A. 36 19
Speer v. Colbert, 200 U.S. 130, 26 S.Ct. 201, 50 L.Ed. 403 14
Trinidad v. Sagrada Orden De Predicadores, 263 U.S. 578 , 68 L.Ed. 458, 44 S.Ct. 204 28
U. S. v. Community Services, Inc., 189 F.(2d) 421 (C.A. 4), cert. den. 342 U.S. 932, 96 L.Ed. 694, 72 S.Ct. 375 ..... 25, 27
U. S. v. Pierce, 137 F.(2d) 428 (C.A. 8) 29
Welch, E. Sohier, et al., Trustees, 9 B.T.A. 1370 19
Whitehead, J. B., Estate of, 3 T.C. 40 40

STATUTES

Internal Revenue Code (1939)
Sec. 23(o) 6, 8, 22, 23
Sec. 54(f) [26 U.S.C. (1944 ed.) Sec. 54(f), 58 Stat. 36] 3, 4, 11
Sec. 101 ..... 8, 25, 27
Sec. 101(6) [26 U.S.C. (1939 ed.) Sec. 101(6), 53 Stat. 33] 2, 4, 11, 12, 15, 24, 26, 27, 28
Sec. 162(a) [26 U.S.C. (1939 ed.) Sec. 162, 53 Stat. 66] .. 2, 3, 4, 11, 12, 14, 15, 16, 18, 21, 22, 23, 26
Sec. 162(c) 19
Sec. 162(g) 17
Sec. 162(g)(4) 17, 18, 19, 21
Sec. 272 11
Sec. 275(a) [26 U.S.C. (1939 ed.) Sec. 275(a), 53 Stat. 86] 3, 4

Page

Secs. 421-424 ..... 19, 27
Sec. 812(d) 6
Sec. 1004(a)(2) 6, 8

Internal Revenue Code (1954)
Sec. 501 27
Sec. 502 25
Secs. 511-515 27
Sec. 642(c) 15, 16
Sec. 674(b)(4) 29
Sec. 681 (68 A. Stat. 232) 15, 19
Sec. 681(c) 17
Sec. 6501(g) 31

Revenue Act of 1924
Sec. 219(b) (43 Stat. 253, 275) 23

Revenue Act of 1950
Sec. 301(a) (64 Stat. 947) 19, 27
Sec. 301(b) (64 Stat. 953) 25
Sec. 301(c)(1) (64 Stat. 953) 27, 28
Sec. 321 (64 Stat. 906, 954, 26 U.S.C. (1950 ed.) Sec. 321) 15, 17
Sec. 321(a) (64 Stat. 954) 15, 19, 21
Sec. 322 (64 Stat. 956) 18

28 U.S.C. Sec. 1254 2

MISCELLANEOUS

Charters of Philanthropies, M. M. Chambers (Carnegie Foundation (1948)), pp. 7, 9 14

G.C.M. 423 (V-2 C.B. p. 53) 19

G.C.M. 10423 (X-2 C.B. p. 127) 19

H. Conf. Rep. No. 3125, 81st Cong. 2d Sess., Amend. No. 159 (Cum. Bull. 1950-2 C.B. p. 591) 17

H. Rep. 8920, 81st Cong. 2d Sess., III G (Cum. Bull. 1950-2, p. 413) 16

H. Rep., 81st Cong. 2d Sess., III E(3) and III G (Cum. Bull. 1950-2, p. 568) 17

Page

Operating Principles of the Larger Foundations, Joseph C. Kiger (Russell Sage Foundation, 1954) pp. 29, 39, 42 ..... 14, 29

Restatement of Trusts

Sec. 348 22

Sec. 364 22

S.M. 4613 (V-1, C.B. p. 71) 19, 22

S.M. 4644 (V-1, C.B. p. 277) 18

S. Rep. No. 398, 68th Cong. 1st Sess., p. 25 23

T.D. 5488, Sec. 29.22(a)-21(d) (1946-1 C.B. 19) 29

35 Virginia Law Review p. 1001 21

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No.....

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The John Danz Charitable Trust, by its counsel undersigned, hereby petitions for the issuance of a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit, affirming the judgment of the Tax Court of the United States, finding deficiencies in federal income taxes for the years 1943 through 1947.[1]

OPINIONS BELOW

The opinion of the Court of Appeals (R. 148-157; set forth in Appendix A, *infra*, pp. 33-45) has not yet been officially reported, but is unofficially reported

[1] This case includes two petitions to review decisions of the Tax Court of the United States finding deficiencies due from Petitioner, one involving the calendar years 1943, 1944 and 1945, and the other the calendar years 1946 and 1947. The cases were consolidated in the courts below. In the Tax Court these cases were also consolidated with additional cases wherein the Commissioner sought to tax the income of the John Danz Charitable Trust to the creators of that trust and sought to deny deductions to those who had made contributions to that trust. The Tax Court held against the Commissioner on these contentions and no appeal was taken therefrom.

in 1955 Prentice-Hall, Federal Taxes, Volume 4, Par. 72,999. The opinion of Judge J. Edgar Murdock of the Tax Court (R. 118-129) is reported in 18 T.C. 454 under the name of *John Danz*.

JURISDICTION

The judgment of the Court of Appeals was dated and entered on October 25, 1955 (R. 147, 158; set forth in Appendix B, *infra*, page 47). Petition for rehearing was denied by order dated and entered on May 14, 1956 (R. 159). The jurisdiction of this court is invoked under 28 U.S.C. Sec. 1254.

QUESTIONS INVOLVED

(1) Where the trust instrument establishing an irrevocable charitable trust requires that exempt organization beneficiaries must by a definite future time be designated and all corpus and accumulated income paid to them, is the trust to be denied, as to income accumulated and not paid out during the year earned, the deduction for income permanently set aside for, or to be used exclusively for charitable purposes, granted by Internal Revenue Code (1939) Sec. 162(a), because particular beneficiaries for the accumulated income had not yet been named, and because broad investment powers are given to the trustees?

(2) Is an irrevocable charitable trust, all of the corpus and income of which must go to exempt organizations, to be denied income tax exemption under Internal Revenue Code (1939) Sec. 101(6) for the years 1943 through 1947 because, during those years it operated temporarily, while finding a lessee, a hotel

which was part of a building purchased by the trust as a real estate investment and because, during those years, it operated three small candy shops, the investment in which was *de minimis*, as a means whereby volunteer services could be devoted to raising money for charity?

(3) Did the filing by the charitable trust, for the years 1943, 1944 and 1945, of returns under the provisions of Internal Revenue Code (1939) Sec. 54(f) (providing for the filing of income tax returns by exempt organizations) showing the itemized income and disbursements of the trust, commence the running of the statute of limitations on assessment of tax contained in Internal Revenue Code (1939) Sec. 275(a)?

STATUTES INVOLVED

The statute involved in question (1) is Sec. 162(a) of Internal Revenue Code of 1939:

> "Sec. 162. Net income.
>
> "The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—
>
> "(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment,

acquisition, maintenance or operation of a public cemetery not operated for profit;

* * * "

[26 U.S.C. (1939 ed.) Sec. 162; 53 Stat. 66]

The statute involved in question (2) is Sec. 101(6) of Internal Revenue Code of 1939:

"Sec. 101. Exemptions from tax on corporations.

"The following organizations shall be exempt from taxation under this chapter—

* * *

"(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * "

[26 U.S.C. (1939 ed.) Sec. 101(6), 53 Stat. 33]

The statutes involved in question (3) are Internal Revenue Code of 1939, Sec. 54(f) as added by the Revenue Act of 1943, Sec. 117(a) [26 U.S.C. (1944 ed.) Sec. 54(f), 58 Stat. 36], and Internal Revenue Code of 1939 Sec. 275(a) [26 U.S.C. (1939 ed.) Sec. 275(a), 53 Stat. 86]. These are set forth in Appendix C, *infra*, pp. 49-50.

STATEMENT

The facts as found by the Tax Court (R. 109-118), which included the facts and exhibits stipulated by the parties (R. 81-105, Joint exhs. 1A-22V), may be summarized as follows:

John Danz and Jessie, his wife, of Seattle, Washington, as grantors, on December 31, 1942, transferred to John, William and Fredric Danz as trustees, by written trust instrument, 900 shares of Sterling Theatres, Inc., common stock, the trust to be known as the John Danz Charitable Trust. The trustees were given broad powers over the trust property, including the power to engage in business under various forms, to loan funds of the trust, with or without security, to join in enterprises in which the trustees were personally interested, provided that they exercised good faith in the interests of the trust estate, and in investing or speculating, to combine funds of any trust created by the grantors. The trustees were entitled to receive reasonable compensation for their services, but received none during the taxable years. They were not to be personally liable in the absence of bad faith for any losses from proper use of the trust funds. The grantors were not to derive, and they have not derived, directly or indirectly, any benefit from the trust property.

John Danz was to have the right during his lifetime and by his will to designate the beneficiary or beneficiaries of the trust. Designations were to be in writing delivered to the trustees. Only a corporation or organization "of a type which is within the exemption from federal income tax now granted by paragraph 101 of the Internal Revenue Code and in the event such ex-

emption is hereafter restricted, then also within such restrictions" could be designated and the beneficiary also had to be of the type then specified in paragraphs 23(o), 812(d), and 1004(a)(2) of the Internal Revenue Code so that the contribution, bequest or gift to such beneficiary would be deductible from income and exempt from estate and gift tax and in the event those classes were further restricted, then the beneficiary had to be within such restrictions. Named adult grandchildren or the trustees were to make similar designations covering any amount remaining in the trust after John Danz' death and not covered by his will.

The trust was irrevocable but could be amended in certain respects by the joint action of William Danz, Fred Danz and Leslie Stusser. The power to amend did not include the power to change the beneficiaries or to make a change which would in any way benefit the grantors or their estates. Additional property could be added to the trust. Leslie Stusser was to take the place of John Danz as trustee if occasion arose. Any other vacancy was to be filled by an appointment made by the remaining trustees. The trustees were to act through a majority. The trust instrument was to be governed by the laws of Washington.

Leslie Stusser was not related to or employed by any of the Danzes mentioned herein.

No amendments were made in the trust during the taxable years. John, William and Fredric Danz served as trustees of the trust from its inception throughout the taxable years. Books and records were kept for the trust. Title to all of the assets of the trust has been

taken in the name of the trustees. Bank accounts were maintained for the trust.

John and Jessie Danz made additional contributions to the trust during the taxable years in cash, in stock of Sterling Theatres, Inc., and in stock of Sterling Theatres Company, Inc. William and Selma Jane Danz and Fredric and Selma Danz made cash contributions to the trust during the taxable years. The total contributions made to the trust during the taxable years, taken at the fair market value of each at the time it was made, amounted to $109,542.00. The stock in Sterling Theatres, Inc., and in Sterling Theatres Company, Inc., held by the trust was a small part of the total outstanding stock of those corporations and played no part in the control or management of those corporations.

The trust made the following purchases of real estate:

	Cost	*Year*
Savoy Hotel property, including furnishings and fixtures	$166,440.76	1943
Improved real estate, Seventh and Pike	95,544.23	1943
Improved real estate, Eighth and Pike	42,866.11	1943
Improved real estate, Sixth and University	75,104.70	1946
Improved real estate, San Francisco	42,882.35	1947

It held the properties during the remaining taxable years and received rents therefrom, except that it sold the property at Eighth and Pike in 1946 at a profit of $43,740.78.

The trust purchased a retail candy shop on September 10, 1943, for $1,514.75, another on September 22, 1943, for $875.00, and a third on January 31, 1944, for $1,500.00. It operated each shop after the purchase throughout the taxable years but at some undisclosed time thereafter ceased operating them. Each candy shop was adjacent to a theatre owned or managed by Sterling Theatres, Inc. Jessie Danz managed the three candy shops without pay because she wanted to make a contribution in that way to the acquisition of funds for the charitable trust.

During the taxable years 1943 to 1947, inclusive, Petitioner received $199,671.64 in gross receipts, less operating expenses, from operation of the Savoy hotel and received $246,158.82 from rental of store space in the Savoy hotel building. Petitioner paid out $27,491.57 in interest, real estate taxes and insurance expense on the Savoy hotel building (Joint Exh. 14N Sched. 1).

During the same period Petitioner received $52,650.44 net income from the candy shops, $65,164.34 from rental of real estate other than the Savoy hotel building, $23,458.10 dividends, $4,583.62 gain on sale of securities, $43,740.78 gain on sale of real estate and $5,368.76 interest income (Joint Exh. 14N).

During the taxable years 1943 through 1947, pursuant to designations by John Danz, Petitioner made distributions totaling $65,637.54 to a number of organizations, exempt from tax under Sec. 101, of the types described in Secs. 23(o), 812(d) and 1004(a)(2) of the Internal Revenue Code.

The Humanist Society of Washington, an exempt

organization, occupied a large portion of the Sixth and University Building rent-free from the time of the inception of that organization. The trust received rent from some other space in that building. The building in San Francisco was occupied rent-free by the Humanist Society of San Francisco, an exempt organization.

The intention of the trustees in purchasing the Savoy hotel property was to operate it only until the personal property could be sold and the real property leased to a hotel operator. Efforts were made to find such a lessee but no satisfactory arrangement was made until January 1, 1948. The hotel, at the time it was purchased by the trust, was being operated by a real estate company in Seattle, and that company continued to operate the property for the trust under an oral agreement during the taxable years and until January 1, 1948, when the furnishings were sold for $60,000.00 and the real estate was leased to a hotel operator.

On September 19, 1946, Petitioner filed with the Collector of Internal Revenue an exemption affidavit on Form 1023 together with returns on Form 990 for the calendar years 1943, 1944 and 1945 (R. 83; Joint Exhs. 2A, 3C and 4D). On May 9, 1947, Petitioner filed a return on Form 990 for the calendar year 1946. The returns on Form 990 stated that they were required under Internal Revenue Code Sec. 54(f) (Joint Exhs. 2A, 3C and 4D). On these returns, Petitioner set forth in detail for each year the amounts of contributions received, dividends and interest received, rents received, gross receipts from business activities (setting

forth separately the gross receipts from the Savoy Hotel and from the candy stores), cost of goods sold, compensation paid, interest paid, taxes paid, other operating, administrative and overhead expenses paid, and contributions paid (R. 84-85, Joint Exhs. 2B, 3C and 4D).

On July 3, 1947, pursuant to a ruling by the Commissioner of Internal Revenue that Petitioner was not exempt, the Collector of Internal Revenue wrote to Petitioner demanding the filing of income tax returns on Form 1041. On July 28, 1947, income tax returns on Form 1041 were filed by Petitioner for the calendar years 1943, 1944, 1945 and 1946 (R. 84; Joint Exhs. 6F, 7J, 8H and 9I). On May 6, 1948, Petitioner filed a return on Form 1041 for the year 1947 (R. 84; Joint Exh. 10J). In each of the returns on Form 1041 Petitioner showed the income and expenses, took deductions for contributions paid during the year, and took a deduction in the amount of the balance of the income as constituting income which, pursuant to the terms of the trust agreement, was permanently held and set aside for exempt purposes under Internal Revenue Code Sec. 162(a).

Petitioner has not engaged in any activities to influence legislation or carry on propaganda.

Notice of deficiency for the years 1943, 1944 and 1945 was mailed to Petitioner on October 14, 1949, and petition for redetermination was filed with the Tax Court on January 9, 1950 (R. 85). Notice of deficiency for the years 1946 and 1947 was mailed to Petitioner on March 5, 1951, and petition for redetermination was

filed with the Tax Court on April 9, 1951 (R. 85). Tax Court jurisdiction was based on Internal Revenue Code (1939) Sec. 272.

The Tax Court held Petitioner taxable in each year on all income not actually paid out by it to charitable organizations during that year. Deduction under Internal Revenue Code (1939) Sec. 162(a) was denied by the Tax Court as to income not so paid out on the ground that the accumulated income of the trust might be lost thereafter in bad investments. Exemption under Internal Revenue Code (1939) Sec. 101(6) was denied to Petitioner because Petitioner during the tax years in question was operating the Savoy Hotel and the three candy shops.

The Court of Appeals affirmed, with a dissenting opinion by Judge Pope. The majority denied deduction under the first clause of Sec. 162(a), relating to income "permanently set aside", on the ground that the income could not be permanently set aside unless named beneficiaries for the income had theretofore been designated. The majority denied deduction under the second clause of Sec. 162(a), relating to income "to be used exclusively" for charitable purposes, on the ground that to come within this clause the income must be paid out within the year earned. The majority also denied exemption under Sec. 101(6) because Petitioner during the years involved was operating the hotel and candy shops.

Both courts below held that returns under Internal Revenue Code (1939) Sec. 54(f) were not sufficient to commence the running of the statute of limitations on assessments of deficiencies.

REASONS FOR GRANTING THE WRIT

The denial of deduction under Internal Revenue Code (1939) Sec. 162(a) directly conflicts with decisions of the Seventh and Sixth Circuits and the Court of Claims and conflicts in principle with decisions of this court. Moreover it is inconsistent with, and frustrates the purpose of Congress in enacting, the 1950 amendments to the Internal Revenue Code imposing specific restrictions on Sec. 162(a) deductions and creates substantial confusion as to the present availability of this deduction to charitable trusts where income is being accumulated and where precise beneficiaries are to be selected in the future.

The denial of exemption under Internal Revenue Code (1939) Sec. 101(6) directly conflicts with decisions of the Sixth and Third Circuits and the Court of Claims, also conflicts with a decision of this court, and likewise is inconsistent with, and frustrates the purpose of Congress in adopting, the 1950 amendments to the Internal Revenue Code in that it permits and would continue to permit taxation of all of the income of a charitable trust having some income from business sources, in circumstances where the 1950 amendments left the exemption effective and taxed prospectively only the business income itself.

1. Both the Seventh Circuit in *Arthur Jordan Foundation v. Comm.*, 210 F.(2d) 885, and the Sixth Circuit in *Comm. v. Upjohn's Estate*, 124 F.(2d) 73, allowed deduction under Internal Revenue Code (1939) Sec. 162(a) of income of a trust being accumulated for charitable beneficiaries not yet named. Also both cases

involved speculative investment powers. In the *Arthur Jordan* case the trust was operating a store selling musical instruments. In the *Upjohn's Estate* case the principal investment was the common stock of an industrial corporation and the trustees' investment powers were limited by their "discretion".[2] These decisions are directly in conflict with that below.

The majority below attempted by footnote to distinguish the *Arthur Jordan* case, saying that the trust there was "to be all distributed to charitable organizations when the fund had reached $5,000,000.00" and further saying that in the case at bar "there is no mandatory duty upon the trustees to devote the fund to any particular charity at a particular time". However, the fact is that in *Arthur Jordan* when the fund reaches $5,000,000.00 only the income, not the corpus, is to be distributed and the income is not to be distributed to a particular charity but to those charities thereafter to be selected by the trustees. As Judge Pope, dissenting below, stated in pointing out that the majority opinion was in conflict with the *Arthur Jordan* case, the trust agreement at bar requires all of the corpus and accumulated income to be paid upon the death of John Danz to charitable beneficiaries, selected either by directions left by Mr. Danz, or in the absence of those directions, then by certain grandchildren if the youngest has attained the age of 21, failing which the designation shall be made by trustees (R. 29).

The majority decision below places its denial of de-

[2] See full statement of facts in the Board of Tax Appeals decision in the *Upjohn's Estate* case, decided July 9, 1940, and not officially reported but found in Prentice-Hall 1940 B.T.A. Memo. Dec., Para. 40,366.

duction under both clauses of Sec. 162(a) on the ground that there is no permanent setting aside or provision for exclusive use for charity unless named beneficiaries have been designated. This holding conflicts with *Beggs v. United States*, 27 F. Supp. 599 (Ct. Cls.) where deduction of income received by an estate was allowed under the predecessor of Sec. 162(a), the will providing that the executor should distribute the estate to such charities as the executor and the decedent's sister should determine, the particular beneficiaries not having been named during the taxable year.

This holding also conflicts in principle with decisions of this court that trusts stating charitable purposes, where the charitable beneficiaries are to be selected in the future, are valid and the discretion to be exercised in selection of the beneficiaries does not create any uncertainty of disposition, the gift being immediate and absolute. *Ould v. Washington Hospital for Foundlings*, 95 U.S. 303, 24 L.ed. 450; *Speer v. Colbert*, 200 U.S. 130, 26 S.Ct. 201, 50 L.ed. 403. The great majority of charitable foundations today operate under the principle of these cases, with broad charitable purposes and specific beneficiaries being selected from time to time by the trustees or others.[3]

2. After extensive hearings[4] as to what, if any, limits should be put on the deduction allowed to charitable trusts under Internal Revenue Code (1939) Sec. 162(a) [and the exemption of charitable organizations under

[3] Charters of Philanthropies, M. M. Chambers (Carnegie Foundation 1948) pp. 7-9; Operating Principles of the Larger Foundations, Joseph C. Kiger (Russell Sage Foundation, 1954) pp. 29, 39, 42.

[4] House Hearings on Revenue Revisions of 1950, 81st Cong. 2d Sess.

Internal Revenue Code (1939) Sec. 101(6)], Congress by Sec. 321 of the Revenue Act of 1950[5] amended Sec. 162 by adding new provisions denying expressly the deduction under certain specified circumstances. The language of Sec. 162(a) itself was not changed, however, and has been carried through as Sec. 642(c) of the Internal Revenue Code of 1954 without change of substance.

The decision below was based on the court's construction of the language of Sec. 162(a), which remains the same. Consequently the decision is as applicable today as in the tax years here involved. Under the principles announced by the court below, a charitable trust whose precise beneficiaries are to be designated in the future may not secure deduction under Sec. 162(a) of the 1939 Code (nor *a priori* under Sec. 642(c) of the 1954 Code) except for amounts actually paid out during the year. The majority opinion appears to so hold irrespective of whether the investment powers extend to business and speculative investments. Where the trustees have power to engage in business or other speculative investments it is clear that this result follows from the majority opinion. Nor does the opinion appear to make this result dependent on any actual exercise of speculative investment powers by the trustees.

The effect of the decision under current law is illustrated by considering the tax situation of Petitioner for the year 1955 if the decision below stands. In the year 1955 Petitioner operated no business enterprises and all investments were in traditional charitable trust

[5] 26 U.S.C. (1950 ed.) Sec. 321, 64 Stat. 905, 954. Carried forward as Sec. 681 of the Internal Revenue Code of 1954 (68 A. Stat. 232).

assets, but precise beneficiaries had not yet been designated for all of the corpus and accumulated income. It would appear that Petitioner would not be entitled under this decision to any deduction in 1955 under Sec. 642(c) of the 1954 Code for income not actually paid out during 1955 since the precise beneficiaries had not been designated and, assuming that the opinion below intended any further qualifications, since there were speculative investment powers, even though not exercised.

The amendments adopted in and the legislative history of the 1950 act relative to deductions by charitable trusts show that Congress understood that the language of Sec. 162(a) of the 1939 Code, as it stood prior to 1950 and as it remained thereafter, permitted deduction by trusts of income not paid out in the year earned but accumulated for charitable purposes and also show that Congress intended to continue this right of deduction with certain specified future restrictions. The House Ways and Means Committee, stating that under Sec. 162(a) a trust could take a deduction for any amount of accumulated income,[6] reported a bill which would have thereafter denied deduction of any accu-

[6] H.R. 8920, 81st Cong. 2d Sess., III C.B. (Cum. Bull. 1950-2, p. 413). The statement was:

"Your committee has found that virtually the same problems exist with respect to the charitable, etc., income tax deduction taken by trusts under section 162(a) of the Code as exist with respect to the charitable, etc., organizations which are exempt from income tax under section 101(6) of the Code. Section 162(a) permits a trust which is taxable under Supplement E of the Code to deduct any amount of its otherwise taxable income which, pursuant to the terms of the will or deed creating the trust, is 'paid or permanently set aside' for charitable, etc., purposes. Thus, a trust which either distributes or accumulates its income for charitable purposes is, for all practical purposes, exempt from income taxes."

mulated income.[7] The Senate, however, eliminated the provision denying deduction for accumulated income,[8] and the House receded with an amendment denying deduction for accumulated income in years where the accumulations were unreasonable, were used to a substantial degree for other than charitable purposes or invested in such a manner as to jeopardize the interests of the beneficiaries.[9] These restrictions applied only to

---

[7] With certain exceptions not here relevant. H. Rep., ibid, III E(3) and III G (Cum. Bull. 1950-2 pp. 411, 413).

[8] Sen. Rep. No. 2375, 81st Cong. 2d Sess. Title III, Part II. The Senate stated (Cum. Bull. 1950-2 p. 563):

"Section 321 of your committee's bill corresponds to section 321 of the House bill, which section has been rewritten by your committee to eliminate those provisions of the House bill which would have denied a deduction under section 162(a) of the Code with respect to income of any taxable year beginning after December 31, 1950, which was accumulated. * * *."

[9] H. Conf. Rep. No. 3125, 81st Cong. 2d Sess., Amend. No. 159 (Cum. Bull. 1950-2 C.B. p. 591). This amendment which added subsection (g)(4) to Sec. 162, appears as Sec. 321 of the Rev. Act of 1950 (64 Stat. 906, 954) and reads as follows (carried forward as I.R.C. (1954) Sec. 681(c)):

"(4) ACCUMULATED INCOME.—If the amounts permanently set aside, or to be used exclusively, for the charitable and other purposes described in subsection (a) during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year—

"(A) are unreasonable in amount or duration in order to carry out such purposes of the trust; or

"(B) are used to a substantial degree for purposes other than those described in subsection (a); or

"(C) are invested in such a manner as to jeopardize the interests of the religious, charitable, scientific, etc., beneficiaries,

the amount otherwise allowable under subsection (a) as a deduction shall be limited to the amount actually paid out during the taxable year and shall not exceed 15 per centum of the net income of the trust (computed without the benefit of subsection (a))."

The House conference Report discussing the addition of this section, states:

"The House recedes with clerical amendments and an amendment which adds paragraph (4) to section 162(g), which paragraph provides that the amount which would otherwise be allowed under section 162(a) as a deduction for amounts permanently set aside for charitable and related purposes during the taxable year or any prior taxable year

taxable years beginning after December 31, 1950. Revenue Act of 1950, Sec. 322, 64 Stat. 956.

Showing the same understanding of the meaning of the language of Sec. 162(a), the Senate report, moreover, added a new section (eliminated in conference) for filing of information returns by charitable trusts, providing for separate statement of amounts deducted but not yet paid out.[10]

Not only the legislative history of the 1950 act but also the language of the new subsection 162(g)(4)[11] itself indicates the understanding of Congress that, contrary to the decision below, accumulated income is deductible under both the "permanently set aside" and the "to be used exclusively" clauses of Sec. 162(a).[12]

---

and not actually paid out at the end of the taxable year shall be limited to such amounts as actually paid out as are not in excess of 15 per cent of the net income of the trust, computed without the benefit of section 162(a), where the accumulations are (1) unreasonable either in size or duration, or (2) used to a substantial degree for other than charitable or related purposes, or (3) invested in such a manner as to jeopardize the interests of the religious, charitable, scientific, etc., beneficiaries. The deductions are to be so limited as provided in this paragraph in the year in which the accumulation becomes unreasonable or is misused and will continue to be so limited until such situation is corrected."

[10]"Trusts claiming charitable, etc., deductions under section 162(a) of the Code shall be required to file the following information annually at such time and in such manner as the regulations may prescribe:

"(1) the amount of the charitable deduction taken under section 162(a) within such year (showing separately the amount of such deduction which was paid out and which was permanently set aside for charitable, etc., purposes during such year),

"(2) the amount paid out within such year which represents amounts for which charitable, etc., deductions have been taken in prior years,

"(3) the amount for which charitable, etc., deductions have been taken in prior years but which has not been paid out at the beginning of the year,

* * *"

[11]See footnote (9).

[12]This is in accord with long-settled construction. S.M. 4644 (V-1, C.B.

The majority below states that the "to be used exclusively" clause "must mean that, although the beneficiaries are not yet designated, the funds are to be disbursed 'within the taxable year'" (App. A, *infra*, p. 39). This deprives that clause of any meaning or effect because Internal Revenue Code (1939) Sec. 162(*c*) gives to a trust the right to deduct all distributions of income actually paid out during the year, whether to private or charitable beneficiaries.

The Revenue Act of 1950 also indicates the understanding of Congress that the existence of broad investment powers does not deprive a charitable trust of deduction for accumulated income. The restrictions imposed by this act, applicable only to years after 1950, are that deduction will be denied in years where there are investments made in such a manner as to jeopardize the interests of the beneficiaries.[13] Even the provisions denying deduction after 1950 for certain types of business income deny deduction only as to the actual income of this type received.[14] There is no provision denying deduction of other types of income just because the trustees have power to make, or have received some income from, business or speculative investments.

---

p. 277); S.M. 4613 (V-1 C.B. p. 71); G.C.M. 423 (V-2 C.B. p. 53); G.C.M. 10123 (X-2 C.B. p. 127); *Bowers v. Slocum*, 20 F.(2d) 350 (C.A. 2d); *Comm. v. Citizens & Southern National Bank*, 147 F.(2d) 977 (C.A. 5th); *Beggs v. U.S.*, 27 F. Supp. 599 (Ct. Cls.); *Herbert J. Slocum, et al, Executors*, 6 B.T.A. 36; *E. C. Johnson, Executor*, 13 B.T.A. 850; *Hu L. McClung, et al, Executors*, 13 B.T.A. 335; *E. Sohier Welch, et al, Trustees*, 9 B.T.A. 1370; *Irving Bank—Columbia Trust Co.*, 8 B.T.A. 833; *Lydia Hopkins*, 13 T.C. 952, 973.

[13]Rev. Act of 1950, Sec. 321(a) (64 Stat. 954) adding Sec. 162(g) to I.R.C. 1939 and carried forward in Int. Rev. Code (1954) Sec. 681.

[14]Sec. 321(a), ibid, denying deduction for income coming within Supplement "U" (Rev. Act of 1950, Sec. 301(a), 64 Stat. 947, which added as Supplement "U" Secs. 421-424 to I.R.C. (1939)).

The opinion below, however, taxes all the income of Petitioner, except that actually paid out to charities during the year. In the years here involved Petitioner received $388,474.42 income from non-business sources (including rental and sale of real estate, dividends on and sale of stock, and interest) and $252,322.08 income from business sources (operation of the Savoy hotel and candy shops). (See Statement, *supra;* Joint Exh. 14N.) Were the terms of the 1950 amendments applied to the taxable years, only the income from business sources would be taxed and the larger income from non-business sources would not be taxed unless the investments of the trust were made in such a manner as to jeopardize the interests of the beneficiaries, or the accumulations were unreasonable or were used for other than charitable purposes. The very fact that these restrictions were put on effective after 1950 indicates Congress, understanding that the basic statute, without the restrictions, permits the deduction of the income where there are business and speculative investments.

The investments of Petitioner have been very successful and cannot be said to have jeopardized the interests of the beneficiaries — instead the investments have largely enhanced their interests. Petitioner's purchase of the Savoy hotel building, a downtown business building in Seattle with a number of stores and a small hotel, was not unduly speculative, nor was it a use of income for other than a charitable purpose. It was an investment of a type not unusual in foundations and carefully and conscientiously made to increase the fund held for charity. The investment in the candy shops not only was *de minimis,* but likewise was for the purpose

of and did enhance the funds available for charitable purposes, particularly by the use of uncompensated services.

When Congress in Sec. 321(a) of the 1950 act denied deduction after 1950 where investments jeopardized the interests of beneficiaries and denied deduction of certain types of business income, it spoke of actual investments made and actual income of this type received, not of the mere power to make speculative investments.[15] Power to make speculative investments is a common feature of foundations created in this inflationary period. As early as 1945, thirty-nine per cent of all the charitable and educational institutions which filed information returns listed business income as part of their total receipts.[16] Yet the decision below appears to deny deduction of all income, business or otherwise, where there are speculative investment powers in existence, whether or not used.

We submit, then, that the decision below in denying deduction of all income, whether from business or otherwise, restricts the deduction more than do the 1950 amendments. Since this restriction by the court below is based on the language of Sec. 162(a) itself, it would permit similar treatment today and would frustrate the evident intent and purpose of Congress that under Sec. 162(a) deduction of income is permitted despite power to make business or speculative investments and that after 1950 the right of deduction as to

---

[15] I.R.C. (1939) Sec. 162(g)(4) as added by Sec. 321(a) of the Rev. Act of 1950.

[16] 35 Virginia Law Review p. 1001.

all except the business income itself should continue unless abused in certain specifically provided particulars.

The Treasury recommendations for changes in 1950 said nothing about a requirement that beneficiaries be named before deduction would be allowed and the amendments adopted did not deal with that subject. This fact indicates Congressional intent that named beneficiaries are not required. That was the interpretation which had been given to Sec. 162(a) at the time the 1950 amendments were considered.[17]

One of the basic distinctions between a charitable and a private trust is that a charitable trust may be created although there is no definite or definitely ascertainable beneficiary designated. Restatement of Trusts, Sec. 364. The trustee must, however, hold the property for a charitable purpose. Ibid, Sec. 348. Since charitable trusts inherently involve property held for charitable purposes but for unascertained beneficiaries, it can be seen why Congress in Internal Revenue Code (1939) Sec. 162(a) provided for deduction of income permanently set aside for charitable "purposes" rather than for charitable "beneficiaries." The decision below substitutes the word "beneficiaries" for the word "purposes" in this statute.

The Tax Court decision in this case, which has been affirmed by the Court of Appeals, allowed under Internal Revenue Code (1939) Sec. 23(o) deduction to

[17] In addition to *Comm. v. Upjohn's Estate*, 124 F.(2d) 73 (C.A. 6) and *Beggs v. U.S.*, 27 F. Supp. 599 (Ct. Cls.) above cited, see *Estate of J. B. Whitehead*, 3 T.C. 40, aff'd *sub nom Comm. v. Citizens & Southern National Bank*, 147 F.(2d) 977 (C.A. 5). Also see S.M. 4613, V-1 C.B. 71, C.f. *Wm. H. Donner*, 40 B.T.A. 80; *Eppa Hunton IV*, 1 T.C. 821 (acq. 1943 C.B. 12).

various parties for contributions made to Petitioner while simultaneously denying deduction by Petitioner of its income. Both the corpus and the income of Petitioner are held under identical trust provisions, and are subject to the same investment powers and the same provisions as to selection of beneficiaries and distribution. Since Secs. 23(o) and 162(a) have the same scope (in fact Sec. 162(a) is expressly conditioned on Sec. 23(o)), the result is inconsistent.[18] If not corrected, it will cause the draftsman of a charitable trust with broad investment powers and provision for accumulation and future designation of beneficiaries, to pursue artificial methods, such as to create two charitable trusts, one of which, having broad investment powers, makes the investments, receives the income and distributes currently to the other, taking a deduction therefor, and the second, having little or no taxable income, accumulates for beneficiaries to be designated. An incorrect decision which imports artificiality of this sort into the tax law should not be permitted to stand.

This court considered Sec. 162(a) in *Old Colony Trust Co. v. Comm.*, 301 U.S. 379, 81 L.ed. 1169, 57 S. Ct. 813, which involved a trust for both private and charitable purposes where the income could have been used for either. The issues were whether amounts ac-

[18]When the Revenue Act of 1924, Sec. 219(b) (43 Stat. 253, 275) added the "to be used exclusively" clause to the predecessor of I.R.C. (1939) Sec. 162(a), the Senate Committee stated that the purpose of the amendment was "to permit as an additional deduction that part of the gross income which, pursuant to the terms of the will or deed, is to be used exclusively (for charitable purposes), since contributions by individuals to organizations for these purposes are deductible under Sec. 214(a)(10) (the predecessor of I.R.C. Sec. 23(o))." S. Rep. No. 398, 68th Cong. 1st Sess. p. 25. This further indicates Congress' intention that the two sections should have the same scope.

tually paid to charities were paid pursuant to the trust instrument where the trustees were given discretion between private and charitable purposes, and whether the payments must be shown to have been made out of income. The deductions were approved. The case did not involve the issue here presented as to whether income is permanently set aside or to be used for charitable purposes where the trust instrument requires eventual payment to charities but the precise beneficiaries have not yet been designated. It is interesting to note, however, that in the *Old Colony* case, the trustees were given the right to select beneficiaries and the class of beneficiaries permitted was described in the language of the income tax exemption section (Internal Revenue Code (1939), Sec. 101(6)), much like was done in the trust instrument at bar.

3. In denying exemption under Internal Revenue Code Sec. 101(6), the court below merely quoted language from its own decision in *Ralph H. Eaton Foundation v. Commissioner,* 219 F.(2d) 527 (C.A. 9), to the effect that the corporation there involved was not exempt because engaged exclusively in business activities for which it had been established.[19] The denial of exemption to Petitioner on this ground conflicts with the decision of the Sixth Circuit in *Comm. v. Orton,* 173 F.(2d) 483, holding that Sec. 101(6) exempted from tax a charitable trust created to operate an industrial business. It also conflicts with two decisions involving corporations: *C. F. Mueller Co. v. Comm.,* 190

[19]The Ninth Circuit opinion in the *Eaton* case likewise pointed out, however, that the articles of incorporation there involved did not prevent reversion of the assets to private use on liquidation.

F.(2d) 120 (C.A. 3) exempting a corporation conducting a macaroni manufacturing business where all profits and assets were held for the benefit of New York University School of Law, and *Sico Co. v. United States*, 102 F. Supp. 197 (Ct. Cls.) exempting a corporation carrying on the business of distributing petroleum products where the profits were payable to public school districts.

This court denied certorari in *U.S. v. Community Services, Inc.*, 189 F.(2d) 421 (C.A. 4), cert. den. 342 U.S. 932, 96 L.ed. 694, 72 S.Ct. 375, which is in conflict with *Mueller* and *Sico Co.* However, this court had before it a memorandum for the government stating that the 1950 legislation had made the issue under Sec 101(6) presented by that conflict completely academic after 1950 and stating that review could serve to resolve the question only in a narrow class of cases.

In *Community Services* (and similarly in *Mueller* and *Sico Co.*), the corporation had been organized expressly for the purpose of taking over an existing business and did on organization take over and operate a retail coal and ice business and a canteen refreshment service then being operated by a private corporation. The Revenue Act of 1950 had added to Internal Revenue Code Sec. 101, a provision that an organization operated for the primary purpose of carrying on a trade or business for profit should not be exempt.[20] The Fourth Circuit held that this provision was declaratory of, rather than a change of, existing law. While this is a point of conflict between the Fourth Circuit on

[20]Rev. Act of 1950, Sec. 301(b) (64 Stat. 953); now found as Internal Revenue Code, 1954, Sec. 502.

the one hand and the Third Circuit and the Court of Claims on the other in the cases above cited, there was basis for the statement in the government's memorandum in this court that in the case of a charitable corporation organized *for the primary purpose* of carrying on a trade or business for profit, the issue as to Sec. 101(6) was moot after 1950 because controlled expressly by the 1950 amendment.[21]

In the case at bar, however, the findings of fact establish that Petitioner was not organized or operated for the primary purpose of carrying on a trade or business for profit. Petitioner took over no business enterprise on organization. Petitioner's initial corpus consisted solely of stock in a corporation, which it still retains. When the Savoy hotel building was later acquired as one of a number of real estate purchases, it was acquired as a real estate investment. The rental from stores in the building during the taxable years amounted to $246,158.82, which exceeded the income from operation of the hotel during the same period, which was $199,671.64. Petitioner did not intend or desire to operate the hotel and made immediate and continuous efforts to find a hotel operator tenant and operated the hotel through a real estate firm only until that tenant was found. Moreover, as to the candy shops, the investment in them was about six-tenths of one per cent of the investments made by Petitioner and was *de minimis*,

[21] It is to be noted that the issue as to deductions of a trust under Sec. 162(a) is not rendered moot after 1950 even where operation of a business was the primary purpose of the trust because the 1950 Act contained no "primary purpose" provision applicable to deductions under Sec. 162(a) but merely denied deduction after 1950 of the business income itself. See footnote 14, *supra*.

certainly not indicating any primary purpose of operating business enterprises, particularly since they were acquired as a means whereby one of the grantors could devote her uncompensated services to charity.

The case at bar, we submit, does not come within the meaning of the "primary purpose" provision of the 1950 Act. While the 1950 Act added Supplement "U" to the Internal Revenue Code subjecting to tax after 1950 specific types of business income,[22] it expressly provides that exempt status nevertheless continues under Sec. 101(6).[23] Therefore under the 1950 Act, where a charitable organization has some business income but does not have as its *primary purpose* the operation of a trade or business, it is exempt from tax on all income except that which is specifically subjected to tax by the 1950 Act. The majority (in fact $388,474.42 as compared to $252,322.08) of the income of Petitioner in the taxable years would not have been taxed after 1950 if it had been received after that time and was subject to the terms of that Act free from the implications of the decision below. The decision below, in denying Petitioner entirely exemption under Sec. 101(6), goes beyond the 1950 Act and is not supportable by the reasoning of the Fourth Circuit in *Community Services* that

[22]Rev. Act of 1950, Sec. 301(a) (64 Stat. 947) adding as Supplement "U" Secs. 421-424 to I.R.C. (1939), now found as I.R.C. (1954) Secs. 501, 511-515.

[23]Rev. Act of 1950 Sec. 301(c)(1) (64 Stat. 953) added the following language to I.R.C. (1939) Sec. 101:

"Notwithstanding supplement U, an organization described in this section (other than in the preceding paragraph) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes."

This provision has been carried forward in I.R.C. (1954) Sec. 501.

the 1950 amendments were declaratory of preexisting legislative intent.

For the same reason it cannot be said that the issue under Sec. 101(6) presented by the decision below is moot after 1950. If this decision stands, the government can under present law (since the language of Sec. 101(6) construed by the Court below remains the same) deny a charitable organization exemption as to all its income because it had some business income, even though it did not have a primary purpose of operating a trade or business. The decision below reaches a result directly contrary to the express provisions of Sec. 301(c) of the 1950 Act, limits the exemption further than the express limitations adopted by the 1950 Act, and frustrates the intention of Congress to specify by the 1950 Act the tax effect in years after 1950 of the receipt of business income on exemption under Sec. 101(6).

In view of the fact that the business income of Petitioner arose, not from a primary purpose of Petitioner to operate a business enterprise, but incidentally as a necessity in the making of a real estate investment and as a means whereby uncompensated services could be devoted to charity, we submit that the decision below conflicts with the holding of this court in *Trinidad v. Sagrada Orden De Predicadores*, 263 U.S. 578, 68 L.ed. 458, 44 S.Ct. 204. The predecessor of Sec. 101(6) was there held to cover an organization which had made large investments in real estate, securities and loans on interest, and likewise secured revenue from sales of wine, chocolate, etc.

4. The result below may have been influenced by the fact that during his lifetime John Danz, a grantor, could designate the beneficiaries of Petitioner. However, creation of charitable trusts with reservation of the right in a grantor to designate charitable beneficiaries has been encouraged by governmental policy. By regulation [T.D. 5488, Sec. 29.22(a)-21(d) (1946-1 C.B. 19)] later incorporated in the statute [Int. Rev. Code of 1954, Sec. 674(b)(4)], both expressing prior administrative practice, a grantor, while normally taxable on the income of a trust where he retains the right to designate beneficiaries, is not so taxable where those beneficiaries are irrevocably required to be charitable organizations. The decisions are to the same effect[24] and also have uniformly held that the right of a grantor to designate beneficiaries did not destroy the charitable exemption of the organizations.[25] In fact, it is probable that in the early years of most foundations the donor determines who will receive the grants.[26]

The majority opinion below stressed the possibility of joint investments with the funds of certain private trusts, created by the same instrument, in such a way

[24] *U.S. v. Pierce*, 137 F.(2d) 123 (C.A. 8); *Wm. H. Donner*, 10 B.T.A. 30; *Edw. Mallinckrodt, Jr.*, 2 T.C. 1123. In cases involving deductions for gifts to trusts where the grantor or a member of his family reserved the right to select beneficiaries it also has been held that the trusts were organized and operated for charitable purposes. *Schoellkopf v. U.S.*, 124 F.(2d) 932 (C.A. 2) affirming *Schoellkopf v. U.S.*, 36 F. Supp. 617 (W.D.N.Y.); *Eppa Hunton IV*, 1 T.C. 821 (acq. 1943 C.B. 12); *A. W. Mellon*, 36 B.T.A. 977.

[25] *Harrison v. Barker Annuity Fund*, 90 F.(2d) 236 (C.A. 7); *Schoellkopf v. U.S.*, 124 F.(2d) 932 (C.A. 2); *Wm. H. Donner*, 10 B.T.A. 30; *Estate of Louise V. Simpson*, 2 T.C. 963; *Eppa Hunton IV*, 1 T.C. 821 (acq. 1943 C.B. 12); *Cummins-Collins Foundation*, 15 T.C. 613.

[26] *Operating Principles of the Larger Foundations*, Joseph C. Kiger (Russell Sage Foundation, 1954) p. 42.

as to suggest that Petitioner as a charitable trust was not an independent entity with its own separate assets or to suggest that there had been or could be confusion between these trusts which might result in private benefit from the charitable trust funds. The trust instrument, however, commanded the creation of entirely separate trusts and provided that the assets, together with the increase and proceeds thereof, of each must be held exclusively for the beneficiaries and purposes specifically set forth for that particular trust (R. 24-25). In making investments, funds of the charitable trust could be combined with funds of the private trusts (R. 26) but there was no modification of the duty specifically imposed on the trustees to hold all corpus and income of each trust exclusively for the purposes and beneficiaries of that trust, and, in fact, the requirement of good faith in the making of investments was specifically enjoined upon the trustees (R. 26, 27). In the actual operation of Petitioner there have been no joint investments (R. 117) and all assets of Petitioner have been held separately by it and accounted for by its own separate books and records (R. 112). The trust instrument specifically provides that no funds or property of the charitable trust may benefit any other than a qualified charitable beneficiary (R. 30) and particularly provides against any benefit to the grantors (R. 26, 30-31).

5. Determination below that the returns on Form 990 were not sufficient to commence the running of the Statute of Limitations on assessment of tax is inconsistent with the principles of this Court's decision in *Germantown Trust Co. v. Comm.*, 309 U.S. 304, 84 L.ed. 770, 60 S.Ct. 566. A fiduciary return filed by a trust was

there held to start the running of the Statute on taxation as an association taxable as a corporation, for the reason that the fiduciary return contained all the data necessary for computation of tax even though it showed no tax due. The Form 990 returns here contained in detail all information on Petitioner's income and expenses from which tax could be computed.

Where a fiduciary in good faith considers the trust exempt and files an information return as provided by law for such cases, the result of a holding that the statute does not commence running is to leave the fiduciary without means of protection by a limitation period except by filing a regular return and not claiming his exemption. Both the injustice of this and the fact that the information return does contain sufficient data for computation of the tax were recognized by Congress when it enacted Sec. 6501(g) of the Internal Revenue Code of 1954 providing that an information return of an exempt organization shall start the running of the Statute of Limitations.

CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted.

F. A. LeSourd,
Attorney for Petitioner

15th Floor, Hoge Building,
Seattle 4, Washington.
June 7, 1956

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

THE JOHN DANZ CHARITABLE TRUST, *Petitioner*, vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent*.	No. 13,608 Oct. 25, 1955

UPON PETITIONS TO REVIEW DECISIONS OF THE TAX COURT OF THE UNITED STATES

Before: POPE and FEE, Circuit Judges, and CLARK, District Judge

JAMES ALGER FEE, Circuit Judge:

The instant petition was filed to review a decision of the Tax Court, which ordered and decided that there were deficiencies in the income tax of petitioner for three years: 1943, 1944 and 1945. There are three questions presented:

> "1. Whether the trust, which was authorized to and did conduct businesses for profit, was 'organized and operated exclusively for * * * charitable * * * purposes', and is thus exempt from tax under Section 101(6) of the Internal Revenue Code, simply because the trust fund is payable only to such exempt organizations as John Danz, one of the grantors, shall designate from time to time during his lifetime and, upon his death, by his will.
>
> "2. Whether the trust net income of the taxable years not actually paid to charitable organizations during the taxable years was, pursuant to the trust

instrument, 'permanently set aside' for charitable purposes during the taxable years, and is thus deductible under Section 162(a) of the Code, even though the income was subject to use by the trustees for speculative investments and for the purchase and operation of trades and businesses, and charitable organizations could receive only such trust funds as John Danz designated during his lifetime (for which deduction has been allowed) and which remained at his death.

"3. Whether the filing by taxpayer of Form 990 returns required of exempt organizations under Section 54(f) of the Code started the running of the three-year limitation period prescribed by Section 275(a) for assessment of taxes so as to bar collection of the income tax deficiencies for 1943, 1944 and 1945."

John Danz and Jessie Danz were grantors in a written trust agreement whereby there were conveyed to Trustees 6,228 shares of stock in a theatre corporation, of which 900 shares were allocated to The John Danz Charitable Trust and the balance to six other private trusts. The powers of the Trustees as to all these trusts were broadly defined in the same instrument. They were permitted to "invest funds of the trust estates in any property * * * and whether or not speculative in character. They may carry on any trade or business on behalf of the trust estates. * * * They may loan funds of the trust estates with or without security. * * * In investing or speculating with trust funds, trustees may combine funds of any trusts created by grantors, whether created by this or any other instrument."

The Trustees were not intended, as the above provi-

sions show, to act as a religious, educational or charitable institution. But, apparently, the profits of operations were to be turned over to The John Danz Charitable Trust, "Trust A", and to the six private trusts pro rata according as the funds of each were used in the particular business or speculation. Trust A, the funds of which were to be used in such business or speculation, was not a religious, educational or charitable institution. There were, however, clauses which required that, as beneficiaries, there were to be designated by John Danz or his successors in power of appointment, only a corporation or organization "of a type which is within the exemption from Federal Income Tax now granted by Paragraph 101 of the Internal Revenue Code," as it then stood or was thereafter restricted, and also of the type there specified in Sections 23(o), 812(d) and 1004(a)(2) of the Internal Revenue Code, so that the contribution bequest or gift to such beneficiary would be deductible from income and exempt from estate and gift tax, then or in the future.

During the years in question, additional contributions were made to Trust A in the sum of $109,542.00. Stocks were bought and sold or held by the Trustees. Some real property was also bought and sold at a profit. Other pieces were held for rent. The Savoy Hotel was purchased in 1943 and operated at a handsome profit during the years in question. Three candy shops were purchased out of Trust A funds in 1943 and 1944 and operated at a great profit. Jessie Danz managed these stores without compensation in order to make a contribution to Trust A.

Trust A made no distributions in 1943. Thereafter, it

made distributions to a number of organizations exempt from tax under §101 and which met the other limitations above referred to. The total of the charitable contributions thus made was $65,637.54. Two-thirds of this sum, approximately, were contributed in 1947. The corpus of Trust A materially increased during the taxable years.

The Tax Court held petitioner Trust A was not exempt under §101(6) and that petitioner was taxable as a trust and not as an association. It was decided that petitioner was not entitled to a deduction under §162(a) for income not distributed during the taxable year. Full credit was given for distributions to the defined charitable institutions in each of the taxable years. Finally, it was held that the Statute of Limitations had not run against the collections of the deficiencies assessed.

So far as the claim of exemption under §101(6) of the Code is concerned, the case is ruled by our opinion in Ralph H. Eaton Foundation vs. Commissioner of Internal Revenue, No. 14,047, February 15, 1955, 219 F.2d 527:

> "The articles state that the purpose of the corporation is to foster and promote religious, charitable and educational enterprises, and that it does not contemplate pecuniary gain or profit to the members thereof. Clearly, however, the corporation itself was not intended to operate and did not operate as a religious, educational or charitable institution. What was purposed was only that the profits from its various business activities would be turned over to such institutions. In a word, petitioner is a 'feeder' corporation whose principal activities have not the remotest connection with

any religious, charitable or educational enterprise." (p. 528)

and again:

"The record shows that it engaged actively and exclusively in various commercial or business enterprises, namely farming, selling of real estate lots, the selling of sport clothes, and in a construction business. * * * All of the latter had to be and were engaged in activities which carried out the purposes and ideas for which petitioner had been established. * * * But assuming the function of turning over the profits was an activity or operation it certainly was not the principal one. We agree with the Fourth Circuit that the word 'exclusively' as used in the statute must be given effect." (pp. 528-529)

Subsidiary reliance is placed upon §162 Net Income (26 U.S.C.A., 1946 Ed., §162), which reads:

"The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

"(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit; * * *."

If the first portion of this section be applied, there is

no exemption beyond that allowed. All payments by Trust A to strictly charitable corporations or concerns have been allowed. Any others were not paid or permanently set aside during the current year.

If exemption is sought under the second clause, the attempt is futile. Otherwise, no meaning is given to the word "exclusively." It is plain that these funds, when mingled with the funds of private trusts for business or speculative purposes and considering the risk of loss, were not used exclusively for religious, charitable or other like purposes.[1] Trust A did not expressly dedicate any funds beyond those it disbursed to such purposes. The mere fact that the remaining funds, after partial or complete recapture from the channels of business or the marts of trade, whenever in a future more or less removed, in the discretion of the Trustees, they chose to pay these over, would necessarily be paid to institutions defined as charitable, does not satisfy the statute. There is another circumstance which compels consideration. John Danz, as settlor, was under no compulsion to exercise his power to designate charitable beneficiaries. If he failed to do so, the funds might during his life have been devoted "exclusively" to business ventures and commercial pursuits.

The "ultimate destination"[2] test is applicable in

[1] The Arthur Jordan case, 210 F.(2d) 335, does not squarely decide the point which is here before us. There the trust was to be all distributed to "charitable" organizations when the fund had reached $5,000,000.00. Here there is no mandatory duty upon the Trustees to devote the fund to any particular charity at a particular time.

[2] As Judge Healy points out, this Court is not pledged to the use of the ultimate destination test, under other sections of the statute where it might be applied. Ralph H. Eaton Foundation vs. Commissioner of Internal Revenue, 9 Cir., 219 F.(2d) 527. The reasoning of this opinion

strictness to other phrases of the statute. It is not repudiated under circumstances which call for its application. But here an attempt to force the facts to fit the doctrine does violence to the language of the statute The previous clause of the statutory definition requires that the money shall have been "paid or permanently set aside" in order to be exempt. Payment is a positive act. Payment could not be made until there was a designated beneficiary. The context then would seem to require that, to be "permanently set aside," a beneficiary should be pointed out with precision. The section also requires that the payment or permanent setting aside be done "during the taxable year" "for the purposes and in the manner specified in section 23(o)." It is perfectly clear that the deduction could not be allowed under this language.

The intention of Congress is outlined with clarity by this previous section. The word "exclusively" in the next clause must mean that, although the beneficiaries are not yet designated, the funds are to be disbursed "within the taxable year." It is difficult to see how a fund is to be "exclusively" devoted to charitable purposes in any event if a part of it is to be used year after year for speculative and business ventures in conjunction with funds which redound to the profit of private individuals. Money is not "used" for charitable purposes when thus traded with. When any portion of this fund is so used, it would be a contradiction in terms to

indicates distrust of exemptions of trusts or feeders of trusts which are actively engaged in commercial pursuits which have nothing to do with charity except that some fund so earned may eventually be permanently allocated thereto.

say it was devoted "exclusively" to charitable purposes.

The word "exclusively" modifies "purposes" in this clause. It has no relation to the character of the beneficiaries which is dealt with in the preceding clause. As to such beneficiaries, the deduction must be based upon the fact that the payment or permanent setting aside has been definitely accomplished to a named beneficiary. But here, "exclusively" means that the fund cannot be devoted to any other purpose, but the portion claimed as exempt must be "paid or permanently set aside" during the "taxable year" to a particular charity.

If John or Jessie Danz wished to give money to charitable organizations, they should have done so directly without mingling it with speculative or business funds. When the Trustees of Trust A so used the money of that trust, these were by no stretch of the imagination devoted "exclusively to" religious, charitable, scientific, literary or educational purposes.

The Tax Court held that the deficiencies for the years 1943, 1944 and 1945, were assessed by the Commissioner within the three year period, as prescribed by §275(a), from the filing of fiduciary tax returns on Form 1041. Petitioner contends that collection of such deficiencies is barred in that it claims the limitation period should have started when it filed Form 990 information returns required of exempt organizations under §54(f) and Treasury Regulation 111, §29.101-1. This contention has no merit. Petitioner is not such an exempt organization on any theory. The "returns" were insuf-

ficient in that these were voluntary for an organization such as petitioner and did not supply the requisite information to constitute a basis to start the running of the period of limitations under the applicable statute.

The decision of the Tax Court is affirmed.

POPE, Circuit Judge, dissenting.

I have a somewhat different view of the statutes here applicable,—one that has led me to believe that Arthur Jordan Foundation v. Commissioner, 7 cir., 210 F.2d 885, which reaches the opposite conclusion, is correctly decided.

I do not think Ralph H. Eaton Foundation v. Commissioner of Internal Revenue, 9 cir., 219 F.2d 527, furnishes any solution for this case. It was decided upon a claim for exemption under Sec. 101(6) of the Revenue Code which refers to "corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes. . . . " The John Danz Charitable Trust does not come within any of those categories. It is, as the Tax Court pointed out in its opinion, "a genuine valid trust . . . taxable under Supplement E". The tax is imposed by Sec. 161 and the deduction claimed is that allowed by Sec. 162(a).

A difference in phraseology in Sec. 101(6) and Sec. 162(a) suggests a different congressional intent with respect to corporations and foundations on the one hand and trusts on the other. Sec. 101(6) which commanded the decision in the Eaton Foundation case refers to corporations or foundations "*organized and operated* ex-

clusively for religious, charitable", etc., purposes. The words which I have italicized appear to me to be key words. Because Eaton Foundation was not operated exclusively for charitable purposes, it was not entitled to the exemption claimed.

As pointed out in the majority opinion, Sec. 162(a) contains two clauses. The first clause:

> "There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o),"

the second clause:

> "Or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit. . . . "

It seems to me that the first clause is intended to cover the case of a trust which provides for distribution of income both to charitable and non-charitable purposes. Thus if the creator of the trust provides for distribution of income (a) to his grandson, and (b) to the community chest, the deduction relates to that part of the gross income which during the taxable year is paid or permanently set aside for the community chest. However, if the trust instrument makes no provision whatever for the grandson or any other individual and the sole beneficiary under the trust is the community chest,

then the second clause applies since the income "is to be used exclusively for . . . charitable purposes." Thus there is no necessity for any allocation within the taxable year of the income as between an ordinary individual on the one hand and a charity on the other. The second clause begins with the words: "Or *is to be* used exclusively", etc. These are words which themselves point to *future* use.[1] The construction which I here suggest would lead to the same result reached in Arthur Jordan Foundation v. Commissioner, supra.

It is true that here the Trust purchased and operated for a limited time three small candy shops adjoining the theatres which were owned by a theatre company in which the trust held shares of stock. The findings also show that the trustees purchased the hotel property for the purpose of liquidating the personal property and holding the real property for lease to a hotel operator. It is entirely normal for a trust to acquire and own real property and collect the rents and revenues from leases thereof, and the operation of the hotel during the taxable year here involved, while a suitable arrangement for lease was being sought, was no more than incidental to the proper acquisition of real estate for rental purposes.

In Arthur Jordan Foundation, supra, the court said: (p. 889) "But if the ultimate beneficial application of the income is for approved purposes, the bequests so held for investment are, within the meaning of the statute, being used for those purposes. Accordingly, such bequests are deductible.

[1] There is no comparable language, looking to the future, in Sec. 101(6) which was involved in the Eaton Foundation case.

"The principle which to us seems controlling in this case is the reasonable certainty that the beneficent purposes of the trust will be greatly served as the investment fund expands and reaches the goal fixed by the settlor. It may be expected that as the fund increases the income available for direct application to charitable or related purposes will increase accordingly. There can be no other reason, under the terms of the trust instrument, for adding to the fund. On the other hand, anything which retards the growth of the fund necessarily reduces the amount of the income available for direct charitable purposes. The purpose of investment is solely and exclusively to produce more income for those purposes. To subject to tax that part of the income which is retained as a part of the corpus would thus very materially impair the possibility of achieving those objectives."

I am impressed by that language and what was said about the policy of Congress to encourage gifts for charitable purposes. As I have indicated above, I think that the word "exclusively" is inserted in this section for the purpose of making the distinction between trusts which may be set up for dual purposes and trusts which are set up exclusively for charitable purposes. That some of the funds here were invested in candy stores is not sufficient to demonstrate that the income of the trust, whatever it is, is not to be used exclusively for charitable purposes. Even a trust which purchases stocks and bonds might suffer loss in its investments but that would not suggest that the income received by such a trust was for that reason not to be used exclusively for charitable purposes.

I am satisfied that the interpretation the majority give to the word "exclusively" is untenable. They say this "must mean that, although the beneficiaries are not yet designated, the funds are to be disbursed 'within the taxable year'." Disbursement within a taxable year would necessarily be to *named* beneficiaries. The effect of the majority's interpretation is to wipe out this second clause entirely.

It is suggested that the Arthur Jordan Foundation was different in that there the distribution to charitable organizations was to be made when the fund had reached $5,000,000. Says the opinion: "John Danz, as settlor, was under no compulsion to exercise his power to designate charitable beneficiaries." This is unimportant for the trust instrument provides that upon the death of John Danz the amounts remaining in trust A "shall then be distributed" to beneficiaries which must meet the designated requirements. Nothing could be more certain than the death of John Danz.

I am of the opinion that the decision of the Tax Court should be reversed.

(Endorsed:) Opinion and Dissenting Opinion. Filed Oct. 25, 1955. Paul P. O'Brien, Clerk.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

THE JOHN DANZ CHARITABLE TRUST, *Petitioner*, vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent*.	No. 13,608

JUDGMENT

Petitions to Review Decisions of the Tax Court of the United States.

This cause came on to be heard on the Transcript of the Record from the Tax Court of the United States, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the decisions of the said Tax Court of the United States in this cause be, and each of them hereby is affirmed.

(ENDORSED) Judgment

Filed and Entered: October 25, 1955

PAUL P. O'BRIEN, Clerk.

APPENDIX C

Internal Revenue Code §54(f), as added by Revenue Act of 1943, §117(a):

Sec. 54(f) Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. No such annual return need be filed under this subsection by any organization exempt from taxation under the provisions of section 101—

(1) which is a religious organization exempt under section 101(6); or

(2) which is an educational organization exempt under section 101(6), if such organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; or

(3) which is a charitable organization, or an organization for the prevention of cruelty to children or animals, exempt under section 101(6), if such organization is supported, in whole or in part,

by funds contributed by the United States or any State or political subdivision thereof, or is primarily supported by contributions of the general public; or

(4) which is an organization exempt under section 101(6), if such organization is operated, supervised, or controlled by or in connection with a religious organization described in paragraph (1); or

(5) which is an organization exempt solely under section 101(3); or

(6) which is an organization exempt under section 101(15) if such organization is a corporation wholly owned by the United States or any agency or instrumentality thereof, or a wholly owned subsidiary of such a corporation.

Internal Revenue Code (1939 Ed.) (53 Stat. 1) §275(a):

Sec. 275. *Period of limitation upon assessment and collection.* Except as provided in section 276—

(a) *General rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

FILED

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute involved	2
Statement	4
Argument	8
Conclusion	18

CITATIONS

Cases:

Bank of America Nat. T. & Sav. Ass'n v. *Commissioner*, 126 F. 2d 48	10
Beggs v. *United States*, 27 F. Supp. 599	9
Boston Safe Deposit & T. Co. v. *Commissioner*, 66 F. 2d 179, certiorari denied, 290 U. S. 700	10
Commissioner v. *Lane-Wells Co.*, 321 U. S. 219	18
Commissioner v. *Orton*, 173 F. 2d 483	15
Commissioner v. *Upjohn's Estate*, 124 F. 2d 73	9, 10
Germantown Trust Co. v. *Commissioner*, 309 U. S. 304	18
Jordan, Arthur, Foundation v. *Commissioner*, 210 F. 2d 885	9, 10, 13
Langenbach's Estate v. *Commissioner*, 134 F. 2d 590	10
Maloney v. *Glover*, 171 F. 2d 870, certiorari denied, 337 U. S. 917	10
Merchants Bank v. *Commissioner*, 320 U. S. 256	10
Moorman, Charles P., Home for Women v. *United States*, 42 F. 2d 257	10
Mueller, C. F., Co. v. *Commissioner*, 190 F. 2d 120	15
Sico Co. v. *United States*, 102 F. Supp. 197	15
Trinidad v. *Sagrada Orden*, 263 U. S. 578	15
United States v. *Community Services*, 189 F. 2d 421, certiorari denied, 342 U. S. 932	15

390812—56——1

Statutes: Page

Internal Revenue Code of 1939:
Sec. 101 (26 U. S. C. 1952 ed., Sec. 101) 2, 18
Sec. 101 (6) (26 U. S. C. 1952 ed., Sec. 101 (6)) .. 3, 7, 15
Sec. 162 (a) (26 U. S. C. 1952 ed., Sec. 162 (a)) .. 3, 7, 13, 15
Sec. 162 (g) (26 U. S. C. 1952 ed., Sec. 162 (g)) .. 14
Sec. 275 (a) (26 U. S. C. 1952 ed., Sec. 275 (a)) .. 3–4, 8, 18
Sec. 421 (26 U. S. C. 1952 ed., Sec. 421) 16
Sec. 422 (a) (26 U. S. C. 1952 ed., Sec. 422 (a)) .. 17
Sec. 422 (b) (26 U. S. C. 1952 ed., Sec. 422 (b)) .. 17
Internal Revenue Code of 1954:
Sec. 502 (26 U. S. C. 1952 ed., Supp. II, Sec. 502) .. 16, 18
Sec. 511 (26 U. S. C. 1952 ed., Supp. II, Sec. 511) .. 17
Sec. 512 (26 U. S. C. 1952 ed., Supp. II, Sec. 512) .. 13, 17
Sec. 642 (c) (26 U. S. C. 1952 ed., Supp. II, Sec. 642 (c)) 13
Sec. 681 (a) (26 U. S. C. 1952 ed., Supp. II, Sec. 681 (a)) 13
Sec. 681 (b) (26 U. S. C. 1952 ed., Supp. II, Sec. 681 (b)) 14
Sec. 681 (c) (26 U. S. C. 1952 ed., Supp. II, Sec. 681 (c)) 14
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 219 (b) .. 11
Revenue Act of 1950, c. 994, 64 Stat. 906:
Sec. 301 (a) (26 U. S. C. 1952 ed., Secs. 421–422) .. 16
Sec. 301 (b) (26 U. S. C. 1952 ed., Sec. 101) 16
Sec. 321 (a) (26 U. S. C. 1952 ed., Sec. 162) 13

Miscellaneous:
H. Conference Rep. No. 844, 68th Cong., 1st Sess., p. 3 (1939–1 Cum. Bull. (Part 2) 300, 304) 11
H. Conference Rep. No. 3124, 81st Cong., 2d Sess., pp. 32–37 (1950–2 Cum. Bull. 580, 589–592) 12
H. Rep. No. 2319, 81st Cong., 2d Sess.:
Pp. 36–44 (1950–2 Cum. Bull. 380, 408–414) 12
Pp. 42–43 (1950–2 Cum. Bull. 380, 412–413) 13
S. Rep. No. 398, 68th Cong., 1st Sess., p. 25 (1939–1 Cum. Bull. (Part 2) 266, 283) 11
S. Rep. No. 2375, 81st Cong., 2d Sess.:
Pp. 27–31 (1950–2 Cum. Bull. 483, 503–506) 13
Pp. 105–115 (1950–2 Cum. Bull. 483, 557–573) .. 12

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 145

THE JOHN DANZ CHARITABLE TRUST, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 106–129) are reported at 18 T. C. 454. The opinion of the Court of Appeals, together with a dissenting opinion (R. 148–157; Pet. 33–45), is reported at 231 F. 2d 673.

JURISDICTION

The judgment of the Court of Appeals was entered on October 25, 1955 (R. 158; Pet. 47), and a timely petition for rehearing was denied on May 14, 1956 (R. 159). The petition for a writ of certiorari was filed on June 8, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether the trust net income not actually paid to charitable organizations was, pursuant to the trust instrument involved, "permanently set aside" during the taxable years or was "to be used exclusively" for charitable purposes, so as to be deductible under Section 162 (a) of the Internal Revenue Code of 1939, even though charitable organizations might receive only so much thereof as remained at the death of one of the settlors and in the meantime the income could be used for speculative and business ventures in conjunction with funds redounding to the profit of individuals.

2. Whether the trust, which was authorized to and did conduct businesses for profit, was "organized and operated exclusively for * * * charitable * * * purposes", and was thus exempt from tax under Section 101 (6) of the Code, simply because the trust fund was ultimately payable only to charitable organizations.

3. Whether the Form 990 information returns filed by taxpayer trust started the running of the limitations period against assessment under Section 275 (a) of the Code.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.
>
> The following organizations shall be exempt from taxation under this chapter—
>
> * * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation * * *.

(26 U. S. C. 1952 ed., Sec. 101.)

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit * * *.

(26 U. S. C. 1952 ed., Sec. 162.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(26 U. S. C. 1952 ed., Sec. 275.)

STATEMENT

The pertinent findings of fact of the Tax Court (R. 109–117) are based largely on a stipulation of facts (R. 81–105), including a trust agreement (R. 23–35), and may be summarized as follows:

QUESTIONS 1 AND 2

On December 31, 1942, John Danz and his wife, Jessie, residents of Seattle, Washington, executed a trust agrement (R. 23–35) under which they created "The John Danz Charitable Trust" and six other separate trusts called "The John Danz Family Trusts" to each of which they transferred shares of Sterling Theatres, Inc. (R. 23–25). The named trustees of all seven trusts were John Danz and the grantors' two sons, William and Fred Danz. (R. 34.) They were given broad powers over the trust properties, including the power to "carry on any trade or business on behalf of the trust estates, whether or not speculative"; to "use the funds or property of the trust estates in such trade or business"; to devote "in any other manner * * * the funds of the trust estates to the carrying on of any business enterprise" (R. 25); to "loan funds of the

trust estates with or without security"; to "invest or speculate in or otherwise take part in, or loan money to, enterprises in which the trustees are personally interested" provided they exercised good faith in the interests of the trust estates and did not use them in any way so that they might inure to the benefit of the grantors; and, in "investing or speculating with trust funds", to "combine funds of any trusts created by grantors" (R. 26). "Any speculations or investments" made by and "any business enterprises carried on by" the trustees on behalf of the trust estates were to be "entirely at the risk of the trust estates", with no personal liability on the part of the trustees in the absence of bad faith, "even though the speculation, investment or enterprise is one in which trustees are personally interested" (R. 27). The trusts were irrevocable but, by the joint action of three persons, could be amended in certain respects which did not include the power to change the beneficiaries or to make a change which would result in the grantors' or their estates' securing or receiving any part of the corpus or income of the trusts. (R. 33–34.)

"The John Danz Charitable Trust" (hereinafter referred to as the trust), the taxpayer involved here, was created for the purpose of making and supplying money to further an organization with a philosophy, based upon science, pragmatism, experience and research, that would eliminate all differences of opinion and be acceptable to everyone. (R. 110.) Since John Danz knew of no such organization at the time

the trust was created (R. 110), the trust instrument provided that he was to have the right during his lifetime and by his will to designate the beneficiary or beneficiaries of the trust and to change, add, or withdraw beneficiaries, which were to receive trust corpus or income at the times and in the amounts specified by him. The beneficiary or beneficiaries could only be corporations and organizations which are exempt from the federal income tax. (R. 28–30.) Named adult grandchildren or the trustees were to make similar designations covering any amount remaining in the trust after John's death and not covered by his will. (R. 29.)

During the taxable years, 1943 through 1947, the trust borrowed money from John Danz and from Sterling Theatres, Inc., at three percent interest, and at the end of each of the taxable years the trust had outstanding loans payable. At the end of 1943 the loans payable were $138,321.06, at the end of 1946, $109,000, and at the end of 1947, $89,500. (R. 115.)

For the taxable years the trust had a total net income of $404,526.29, which was derived principally from rentals on property purchased during the taxable years and from the operation of four other properties purchased during the taxable years, with some income from stock dividends and the sale of stock and realty purchased during the taxable years. The trust purchased eight pieces of improved real estate. It received rents from four, one of which was sold in 1946 at a profit. Another, the Savoy Hotel, was purchased in 1943 with the idea of leasing it to

a hotel operator, but was operated for the trust until January 1, 1948, by the real estate company which had previously been operating it. The average annual receipts from the hotel for the taxable years were about $141,000, the operating expenses about $96,400 and the net income about $44,600. The other three properties were candy stores, which were purchased for small amounts in 1943 and 1944 and operated by the trust throughout the taxable years. The total sales of the candy stores during the taxable years were $329,233.95, the net sales $158,689.10, expenses $106,435.75, and net profits $52,650.44. The net worth of the trust, as shown on its balance sheets, increased from $65,862.62 at the end of 1943 to $448,420.09 at the end of 1947. (R. 113–117.)

The trust made no distributions to beneficiaries in 1943, but thereafter made distributions in the taxable years to a number of organizations which were exempt from the federal income tax. The total of these charitable contributions was $65,637.54, of which about two-thirds was contributed in 1947. (R. 113, 116.) The income so distributed was not taxed and is not involved in the issues presented here.

The court below, affirming the Tax Court, held that the trust is not exempt from tax under Section 101 (6) of the 1939 Code and that the trust income not actually paid to charitable beneficiaries in the taxable years is not deductible from the trust's gross income under Section 162 (a) of the Code. (R. 148–154; Pet. 33–41). Judge Pope, dissenting, was of the view that

the trust income is all deductible under Section 162 (a). (R. 154–157; Pet. 41–45.)

QUESTION NO. 3

On September 19, 1946, the trust filed with the Collector an exemption affidavit and for 1943, 1944 and 1945 information returns on Form 990 required of exempt organizations. After the Commissioner notified the trust that it was not exempt and should file income tax returns, the trust, on July 28, 1947, filed income tax returns for the years 1943 through 1946. A return for 1947 was filed on May 6, 1948. (R. 83–84.)

On October 14, 1949, the Commissioner mailed to the trust a notice of deficiencies for the years 1943 through 1945. On March 5, 1951, the Commissioner mailed the trust a notice of deficiencies for 1946 and 1947, together with a penalty for 1947. (R. 85.) The Court of Appeals agreed with the Tax Court's ruling that the deficiencies were timely assessed, within three years from the filing of the income tax returns as required by Code Section 275 (a) (*supra*, p. 4), rejecting the claim that the earlier information returns on Form 990 marked the beginning of the limitations period. (R. 40–41.)

ARGUMENT

As to all three questions decided by the court below, the taxpayer-trust asserts conflict with one or more other decisions. Some of the claimed conflicts exist. However, since the issues of this case lie in an area where Congress has enacted comprehensive legisla-

tion, effective for taxable years after 1950, we believe that further review by this Court would not be appropriate.

1. The court below held (Pet. 37–40) that the income of the trust for the taxable years 1943 through 1947 not actually paid to charities in those years was not deductible from the gross income of the trust under Section 162 (a) of the Internal Revenue Code of 1939, *supra,* p 3, because it was not, pursuant to the trust agreement, "during the taxable year * * * permanently set aside" or "to be used exclusively" for charitable purposes. That holding is correct and in accord with all pertinent decisions, with the possible exception of *Arthur Jordan Foundation* v. *Commissioner,* 210 F. 2d 885 (C. A. 7th).[1]

---

[1] In *Commissioner* v. *Upjohn's Estate*, 124 F. 2d 73 (C. A. 6th) (Pet. 12–13), where the annual income of a testamentary trust in excess of annual bequests and other charges was payable to charity at the end of 10 years, decision turned on a rejection of the Commissioner's contention that under the trust instrument the income of one year could be used to pay noncharitable charges upon the trust fund in another year. Since the Court of Appeals did not specifically deal with the further question, which may have been lurking in the case, whether the powers of the trustees over the trust assets were inconsistent with the conclusion that the income not distributed to the charities was being permanently set aside or used exclusively for charitable purposes, we believe that the case is not in square conflict with the decision below.

In *Beggs* v. *United States*, 27 F. Supp. 599 (C. Cls), a deduction was allowed under Section 162 (a) for income of an estate during administration because it became a part of the corpus of the residuary estate which was held to have been bequeathed to charity. Taxpayer's assertion of conflict with that case (Pet. 14) is apparently based only on the fact that there, as here, the charitable beneficiaries had not been named during the taxable year. That fact, however, was not the sole basis of the decision below. (See Pet. 37–40.)

The trust agreement in this case, as accurately paraphrased by the court below (Pet. 39), authorized use of the trust income for "speculative and business ventures in conjunction with funds which redound to the profit of private individuals" (see Statement, *supra*, pp. 4–8). Aside from income actually paid to charities pursuant to John Danz's designations, for which deduction has been allowed, the payment of trust income to charity was required by the trust agreement only as to such portion, if any, which remained at John Danz's death. What part of the income of the taxable years, if any, would ultimately reach charity was uncertain, for all or a part of it might be lost in speculative and business ventures. When income may be used and lost in such ventures it quite clearly is not "permanently set aside" for charitable purposes. It has been so held in comparable situations where the ultimate destination of the income was uncertain because of the possibility of its use for some person or purpose other than charity. See *Merchants Bank* v. *Commissioner*, 320 U. S. 256, 263; *Maloney* v. *Glover*, 171 F. 2d 870 (C. A. 9th), certiorari denied, 337 U. S. 917; *Bank of America Nat. T. & Sav. Ass'n* v. *Commissioner*, 126 F. 2d 48 (C. A. 9th); *Boston Safe Deposit & T. Co.* v. *Commissioner*, 66 F. 2d 179 (C. A. 1st), certiorari denied, 290 U. S. 700; *Langenbach's Estate* v. *Commissioner*, 134 F. 2d 590 (C. A. 6th); *Commissioner* v. *Upjohn's Estate*, 124 F. 2d 73, 76 (C. A. 6th); *Charles P. Moorman Home for Women* v. *United States*, 42 F. 2d 257 (W. D. Ky.).

As in the foregoing cases, the trust income here clearly was not "to be used exclusively" for charitable purposes.[2] The use of trust income in speculative and business ventures is not a charitable use except in the sense that it may possibly produce other income which may ultimately go to charity. Even if that is considered a charitable use, it is not a use "exclusively" for charitable purposes, especially where, as here, the income may be used (Pet. 39) "in conjunction with funds which redound to the profit of private individuals."

Arthur Jordan Foundation v. *Commissioner*, 210 F. 2d 885 (C. A. 7th), is perhaps in conflict in principle with the decision below, although the factual situations are not precisely parallel. That case involved a perpetual trust under which a portion of each year's earnings was to be distributed to charity and the remainder was to be accumulated and added to a permanent investment fund. When the net assets of the trust reached $5,000,000 the entire net annual earnings of the trust were to be distributed currently to charity. The net assets had not reached $5,000,000 during the taxable years and the accumulated income of those years, for which a deduction under Section 162 (a) was allowed, became a part of the permanent

[2] So far as pertinent here, as taxpayer conceded in the court below, the "to be used exclusively" clause, which first appeared in Section 219 (b) of the Revenue Act of 1924, c. 234, 43 Stat. 253, was not intended by Congress to be any broader in scope than the "permanently set aside" clause. See S. Rep. No. 398, 68th Cong., 1st Sess., p. 25 (1939–1 Cum. Bull. (Part 2) 266, 283); H. Conference Rep. No. 844, 68th Cong., 1st Sess., p. 3 (1939–1 Cum. Bull. (Part 2) 300, 304).

investment fund which would never reach any charity, and, in addition, was subject to the risk of loss in two music store businesses carried on by the trust. The deduction for such income appears to have been allowed on the theory that the income was either permanently set aside or used exclusively for charitable purposes because of (p. 889) "the reasonable certainty that the beneficent purposes of the trust will be greatly served as the investment fund expands and reaches the goal fixed by the settlor." The Seventh Circuit, therefore, apparently regarded as a charitable use the investment of income as capital to produce other income to be distributed to charity. It is on that aspect of the case that the decision is out of harmony with the decision below. On the other hand, the decision below emphasizes (see Pet. 39) the fact that here the income could be used year after year "for speculative and business ventures in conjunction with funds which redound to the profit of private individuals", circumstances which were not present in the *Arthur Jordan Foundation* case.

The divergent views of these two Courts of Appeals, however, lie in an area which has been the subject of Congressional concern and where legislation, enacted in 1950, has considerably narrowed, if not eliminated, the area of possible controversy in this field.[3]

[3] The over-all pattern and the details of the 1950 legislation with respect to exempt organizations, charitable deductions by foundations and trusts, etc., are described in the committee reports. See H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 36–44 (1950–2 Cum. Bull. 380, 408–414); S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 105–115 (1950–2 Cum. Bull. 483, 557–573); H. Conference Rep. No. 3124, 81st Cong., 2d Sess., pp. 32–37 (1950–2 Cum. Bull. 580, 589–592).

Section 422, added to the 1939 Code by Section 301 (a) of the Revenue Act of 1950, c. 994, 64 Stat. 906 (and further amended by Sections 339 (b), 347 and 348 of the Revenue Act of 1951, c. 521 65 Stat. 452), contains a comprehensive definition of the terms "unrelated trade or business" and "unrelated business net income", quoted in part at p. 17, *infra*. Under Section 162 (g) (1), as added to the 1939 Code by Section 321 (a) of the 1950 Act, the unlimited charitable deduction which is otherwise available under Section 162 (a) is not allowable with respect to the unrelated business income of the trust. See H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 42–43 (1950–2 Cum. Bull. 380, 412–413); S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 27–31 (1950–2 Cum. Bull. 483, 503–506). Under these related sections, which have been continued in Sections 512 and 681 (a) of the 1954 Code, for taxable years after 1950, no trust has been permitted an unlimited charitable deduction under Section 162 (a) of the 1939 Code or under Section 642 (c) of the 1954 Code with respect to its unrelated business income; and the unlimited deduction with respect to such income is denied not only with respect to amounts permanently set aside or to be used exclusively for charitable purposes, but even with respect to amounts actually paid to a charity. Consequently, under existing statutory provisions, in the situation of the present case and of the *Arthur Jordan Foundation* case, to the extent that each trust might have "unrelated business net income", the unlimited charitable deduction would not be available

and the precise issue decided by the Court of Appeals, namely, whether the income has been permanently set aside or is to be used exclusively for charitable purposes, would never be reached.

Even with respect to other income earned by a trust, and even where the income has been permanently set aside or is to be used exclusively for charitable purposes, Section 162 (g) (2) of the 1939 Code, as added by the 1950 Act (and carried forward in Section 681 (b) of the 1954 Code), placed severe limitations on the charitable deduction if the trust engages in any of six, specifically described "prohibited transactions." And 1939 Code Section 162 (g) (4) and 1954 Code Section 681 (c) impose further limitations on the charitable deduction with respect to the accumulated income of a trust (even though it has been permanently set aside or is to be used exclusively for charitable purposes) if the accumulations are unreasonable in amount or duration, are used to a substantial degree for other purposes, or "are invested in such a manner as to jeopardize the interests" of the charitable beneficiaries. In these situations, the deduction is limited to amounts actually paid out during the year and may not exceed 20 percent of the trust's taxable income.

These further limitations on the charitable deduction will make even more narrow the future area of possible controversy. In short, the issue here, which the taxpayer seeks to have this Court review, is now largely an academic question. To the extent that it is still germane to determine whether trust income is

being permanently set aside or is to be used exclusively for charitable purposes under Section 162 (a) of the 1939 Code or Section 642 (c) of the 1954 Code, we believe it would be preferable to permit the Courts of Appeals to apply the statutory language to new factual situations as they arise since the over-all issues will take on a new significance in the light of these additional, specific indications of legislative intent.

2. The holding below that the trust is not exempt from tax under Section 101 (6) of the Code, *supra*, p. 3, is in conflict with *C. F. Mueller Co.* v. *Commissioner*, 190 F. 2d 120 (C. A. 3d), and *Sico Co.* v. *United States*, 102 F. Supp. 197 (C. Cls.), but, on the other hand, is in accord with *United States* v. *Community Services*, 189 F. 2d 421 (C. A. 4th), certiorari denied, 342 U. S. 932.[4] Again, subsequent statutory changes make it unnecessary for the Court to resolve the conflict with the *Mueller Co.* and *Sico Co.* decisions. Thus, the Third Circuit, in the *Mueller Co.* case, observed (190 F. 2d at 120): "What we do here with the problem is of little importance for the future, since Congress has entered the area of dispute and declared the rule for taxable years commencing after December 31, 1950."

The conflict as to "feeder" organizations—that is, those carrying on a business for profit where the

[4] Contrary to taxpayer's assertions (Pet. 24, 28), the decision below clearly is not in conflict with *Commissioner* v. *Orton*, 173 F. 2d 483 (C. A. 6th), or *Trinidad* v. *Sagrada Orden*, 263 U. S. 578. Each of those cases involved an organization which itself engaged in a charitable or scientific activity.

profits inure exclusively to exempt organizations—existed when certiorari was denied in the *Community Services* case. As we showed in our memorandum in that case (No. 430, October Term, 1951), Section 301 (b) of the 1950 Act (which added a paragraph to Section 101 of the 1939 Code), rendered the conflict largely academic by specifically denying exemption to organizations "operated for the primary purpose of carrying on a trade or business for profit."[5] The same provision has been carried forward as Section 502 of the 1954 Code.

Moreover, there are other provisions of the 1950 Act which substantially dispose of the exemption question as to any and all organizations claiming exemption solely on the basis of the ultimate destination of their income. By Section 301 (a) of the 1950 Act Congress added Section 421 of the 1939 Code to tax the "unrelated business net income" of *exempt* organizations, including exempt trusts. The "unrelated business net income" of an exempt organization is defined in Section 422 (a) as the gross income derived by an organization from any "unrelated trade or business (as defined in subsection (b))" regularly carried on by it, less deductions and with certain exceptions, additions and limitations. The term "unrelated trade or business" is defined in Section 422 (b) as—

> any trade or business the conduct of which is

---

[5] Contrary to taxpayer's argument (Pet. 26–28), its operations during the taxable year (see R. 113–116) seem clearly to put it in the class of organizations operated for the "primary" purpose of carrying on a trade or business.

> not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101, * * *.

See also Sections 511 and 512 of the 1954 Code. Thus, an organization which has no charitable function or purpose other than the use it makes of its profits is taxable, not exempt from tax, on all of its business income. This leaves the narrow area of exemption as to *non*-business income derived by an organization which is not specifically excluded from exemption as being operated for the "primary" purpose of carrying on a trade or business but whose claim to exemption is based solely on the ultimate destination of its income. Even that area seems foreclosed by the clearly stated assumption in the above-quoted portion of Section 422 (b) of the Code, as added in 1950, that a charitable purpose or function other than the use made of profits is the only proper basis for exemption. At all events, such a question would not be reached in the fact situation exemplified by this case where exemption would be denied under the 1950 changes in Section 101 of the 1939 Code and under Section 502 of the 1954 Code.

3. On the third question—whether taxpayer's Form 990 information returns constituted income tax returns for the purpose of starting the running of the limitations period against assessment provided in Section 275 (a), *supra*, p. 4, the decision below

is not in conflict with *Germantown Trust Co.* v. *Commissioner*, 309 U. S. 304. Under that decision one type of return may be a substitute for another type when it contains all the data from which the tax can be computed and assessed. In the present case the court below, as well as the Tax Court before it, held that the Form 990 information returns, required only of exempt organizations, did not supply the requisite information. See also *Commissioner* v. *Lane-Wells Co.*, 321 U. S. 219, 223.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

SIMON E. SOBELOFF,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

HILBERT P. ZARKY,
MELVA M. GRANEY,
Attorneys.

JULY, 1956.

U. S. GOVERNMENT PRINTING OFFICE: 1956

Office - Supreme Court
FILED
OCT 26 195
JOHN T. FEY, Cl

No. 145

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

F. A. LESOURD,
Attorney for Petitioner.

15th Floor, Hoge Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

No. 1010

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST, *Petitioner*,

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

F. A. LESOURD,
Attorney for Petitioner.

15th Floor, Hoge Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST, *Petitioner*, vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent*.	No. 1010

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

Petitioner prays that this Court grant rehearing of its order of October 8, 1956, denying the petition for writ of certiorari and that a writ of certiorari issue to review the judgment of the Court of Appeals for the Ninth Circuit in the above-entitled case as prayed for in the petition filed herein June 8, 1956.

REASONS FOR GRANTING REHEARING AND ISSUING THE WRIT

On the same day that this Court denied certiorari herein, certiorari was granted in *Automobile Club of Michigan v. Comm.*, No. 89. One of the issues raised in the petition for certiorari in the *Automobile Club* case is whether returns filed for the years 1943 and 1944 on form 990 pursuant to I.R.C. (1939) Sec. 54(f), providing for income tax returns by exempt organizations, started the running of the statute of limitations on assessment of tax contained in I.R.C. (1939) Sec. 275(a)

(Pet. pp. 2, 7, 22). Insofar as we are informed, the grant of certiorari was not limited to any particular issues in the case. Consequently, it appears that this issue will be presented to, and may be determined by, this Court.

The same issue is involved in the instant case, the petition for certiorari herein presenting the question of whether returns for the years 1943, 1944 and 1945 on form 990 were sufficient to start the running of the statute of limitations (Pet. pp. 3, 9-10; 30-31).

Both in the *Automobile Club* case and in the instant case, the returns on form 990 were filed in accordance with the regulations of the Commissioner. In the *Automobile Club* case, the Commissioner had ruled the organization to be exempt and the applicable regulations provided for continued filing of income tax returns on form 990. In the instant case, in accordance with the regulations of the Commissioner, the returns on form 990 were filed on September 19, 1946, along with the original application of Petitioner for a ruling on exemption.

The regulations under I.R.C. (1939) Sec. 101, being Sec. 29.101-1 of Regulations 111, as released October 28, 1943 (Title 26, Part 29, Code of Federal Regulations) in effect during the years here involved, provided for filing of applications for rulings on exempt status and required that returns on form 990 be filed with the application. To the same effect, the regulations under I.R.C. (1939) Sec. 54(f) dealing with returns on form 990 stated (T.D. 5381, June 27, 1944, Cumulative Bulletin, 1944, p. 190, amending Regulations 111, Sec. 117):

"For proof and establishment of right to exemption from tax which must accompany Form 990 (revised May, 1944) in the case of an organization which has not established its right to such exemption prior to the filing of the annual return, see subsections (a) and (b) of this section."

Applications for exempt status are not filed until at least a year after the inception of an organization. Where the organization in good faith believes itself exempt it would be inconsistent for it to file returns as a taxable organization while it is awaiting a ruling. This is recognized by the above regulations which required returns to be filed on form 990 rather than on the ordinary income tax return form.

In both the *Automobile Club* case and the instant case, then, the petitioner has in good faith filed the type of income tax return called for by the regulations under the particular circumstances. In both cases the petitioner contends that the returns on form 990 set forth in detail all information necessary for computation and assessment of tax, in the event determination were made that no exemption existed. The Commissioner in each case failed to assess the tax within the statutory period following filing of the returns on form 990. The issue in both cases is the same, namely whether returns on form 990, filed as the particular type of income tax return required by the regulations under the circumstances existing, are sufficient to commence the running of the statute of limitations on assessment of the tax.

This issue as to the statute of limitations has, furthermore, a retroactivity aspect like that of the retroactive reversal of the exemption ruling itself in the

Automobile Club case. At the time of the filing of returns on form 990 in both cases, an Internal Revenue ruling existed that returns on form 990 would start the running of the statute of limitations. While this ruling was not directly published by the Commissioner himself, it was given wide publicity by the Department of Agriculture since it was of vital importance to the large number of newly organized farm cooperatives making exemption ruling applications. See, for example, Report No. 106, April, 1947, Farm Credit Administration, United States Department of Agriculture. Moreover, the Commissioner indicated that returns on form 990 would start the statute of limitations in Sec. 29.101-1 of Regulation 111 above mentioned where, after setting out at length the instances in which returns on form 990 are required, he states:

> "See also sections 275(a) and 276(a) with respect to the statute of limitations."

Under section 275(a) so referred to, the Commissioner stated (Sec. 29.275-1, Regulation 111, as released October 28, 1943):

> "The amount of income tax imposed by the Internal Revenue Code must be assessed within three years after the return was filed."

There is no indication that "the return" would not include the type of income tax return specifically required by Sec. 29.101-1 of the regulations.

We submit, then, that the issue as to whether returns on form 990 started the running of the statute of limitations is the same in the instant case as in the *Automobile Club* case. It is an issue where the petitioner's position has merit and the possibility exists that this

Court will, upon the briefing and argument of the *Automobile Club* case, determine that where proper returns on form 990 are made as required by the regulations, they do commence the running of the statute. Were this Court to so hold in the *Automobile Club* case, a miscarriage of justice would result if the facts of the instant case were not reviewed in the light of the law as so determined. Since the decision of the Tax Court becomes final thirty days after denial of certiorari, petitioner here would have no remedy by awaiting this Court's decision in the *Automobile Club* case and then moving the Court out of time to reopen the instant case. I.R.C. (1954) Sec. 7481.

CONCLUSION

For the reasons set forth above and in the petition for writ of certiorari, it is respectfully urged that rehearing be granted, that this Court's mandate be recalled within 30 days of its issuance and that, upon such rehearing, a writ of certiorari issue to the Court of Appeals for the Ninth Circuit.

Respectfully submitted,

F. A. LeSourd
Attorney for Petitioner.

CERTIFICATE OF COUNSEL

I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to the grounds specified in Rule 58 of the rules of this Court.

F. A. LeSourd
Attorney for Petitioner.

JAN 2 1957
JOHN T. FEY, Clerk

No. [redacted] 145

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

MEMORANDUM SUPPLEMENTAL TO PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

F. A. LESOURD,
Attorney for Petitioner.

15th Floor, Hoge Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

No. 1010

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

MEMORANDUM SUPPLEMENTAL TO PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

F. A. LESOURD,
Attorney for Petitioner.

15th Floor, Hoge Building,
Seattle 4, Washington.

THE ARGUS PRESS, SEATTLE

Supreme Court of the United States

OCTOBER TERM, 1955

THE JOHN DANZ CHARITABLE TRUST,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 1010

MEMORANDUM SUPPLEMENTAL TO PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

Supplementing our petition for rehearing of order denying petition for writ of certiorari filed herein, we wish to set out more fully and more accurately the regulations concerning the type of return to be filed for 1943, 1944 and 1945 by an organization claiming exemption under I.R.C., Sec. 101(6).

Sec. 29.101-1 of Regulations 111 as released October 28, 1943, provided:

> "When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created, except that every organization *exempt or claiming exemption* under section 101 (5), (6), except organizations organized and operated exclusively for religious

> purposes, (7), (8), (9), or (14) shall file *annually* returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization." (Italics supplied)

Following the above language and in the same paragraph, the regulation states:

> "See also sections 275(a) and 276(a) with respect to the statute of limitations."

This regulation was in effect until June 26, 1944, at which time it was amended by designating it as applying to proof of exemption and annual returns for periods prior to January 1, 1943. T.D. 5381 (Cumulative Bulletin 1944, p. 190). This Treasury decision promulgated a new section of the regulation (Sec. 29.101-2) to apply to proof of exemption after January 1, 1943, and annual returns for accounting periods beginning on or after January 1, 1943. This regulation described the affidavit or questionnaire by which claim for an exempt ruling was to be made. It then set out the requirements of annual returns on form 990 by exempt organizations. Following this the regulation stated:

> "For proof and establishment of right to exemption from tax which must accompany Form 990 (Revised May, 1944) in the case of an organization which has not established its right to such exemption prior to the filing of the annual return, see subsections (a) and (b) of this section."

The regulation then deals with the making of group returns on form 990, at the conclusion of which it states:

> "The group return shall be filed in accordance

with these regulations and the instructions on Form 990 (Revised May, 1944) or issued therewith, and shall be considered the return of each of the local organizations included therein. For proof and establishment of right to exemption from tax which must accompany Form 990 (Revised May, 1944) in the case of a local organization included in the group return but which has not established its right to such exemption prior to the filing of the group return, see subsections (a) and (b) of this section."

Before an organization could apply for a ruling on exemption it was required to have operated at least a full year. Any organization claiming to be exempt would, from the above-quoted regulations, draw the conclusion that until it had received a ruling it was required to file returns on form 990 rather than on the regular form. Moreover, the reference to the statute of limitations in Sec. 29-101-1 would reasonably lead to the belief that if these regulations were followed and form 990 filed, the protection of the limitations statute would be afforded.

In these regulations, organizations claiming exemption and those having been ruled exempt are treated alike insofar as the requirement as to tax returns is concerned. Consequently, as is more fully pointed out in our Petition for Rehearing, the question of whether an organization having followed these regulations is to be held to have lost the benefit of the statute of limitations is the same here as in *Automobile Club of Michigan v. Comm.*, No. 89, now awaiting argument in this court.

The majority below denied statute of limitations protection to petitioner on the ground that the filing of returns on form 990 was "voluntary." (See petition for certiorari herein, Appendix A, pp. 40-41.) When the provisions of the regulations cited above are considered, this characterization of the returns as voluntary could be justified only on the premise that the regulations of the Commissioner have no real force and effect and are to be followed or not as the taxpayer desires.

We submit that in light of these regulations, the Commissioner should not now be heard to assert that an organization filing returns on form 990 pending a ruling on its exempt status has no protection from the statute of limitations. *Stockstrom v. Commissioner* (C.A. D.C.) 190 F.(2d) 283; *Balkan Nat. Ins. Co. v. Commissioner* (C.C.A. 2) 101 F.(2d) 75; c.f. *R. H. Stearns Co. v. U.S.*, 291 U.S. 54, applying the same principle against the taxpayer. Also see *Germantown Trust Co. v. Commissioner,* 309 U.S. 304, and *United States v. Tillinghast* (C.C.A. 1) 69 F.(2d) 718, where the fact that the taxpayer had filed the returns provided by the regulations was stressed in holding that the statute of limitations had run.

Respectfully submitted,

F. A. LeSourd,
Attorney for Petitioner.